

Message Text

SECRET

PAGE 01 LONDON 01243 01 OF 03 241554Z
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AMEMBASSY LUXEMBOURG
AMEMBASSY COPENHAGEN
AMEMBASSY DUBLIN

S E C R E T SECTION 01 OF 03 LONDON 01243

FOR THE VICE PRESIDENT

EXDIS

E.O. 11652: GDS
TAGS: PFOR, UK
SUBJECT: YOUR JANUARY 27 MEETING WITH CALLAGHAN

1. WHEN YOU ARRIVE IN LONDON ON THURSDAY, YOU WILL BE
WELCOMED AT NO. 10 WITH OPEN ARMS BY A PRIME MINISTER
AND A GOVERNMENT DEEPLY DEDICATED TO THE AMERICAN CON-
NECTION BUT IN NEED OF REASSURANCE. BESET WITH SYSTEMIC
ECONOMIC PROBLEMS, BADLY BRUISED BY YET ANOTHER STERLING
CRISIS LAST FALL, AND WEAKENED BY TRENCH WARFARE IN
PARLIAMENT RIGHT UP TO THE CHRISTMAS BREAK, CALLAGHAN'S
BATTERED GOVERNMENT IS CURRENTLY ENJOYING SOMETHING OF A
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PAGE 02 LONDON 01243 01 OF 03 241554Z

BREATHES. IT WON'T LAST.

2. BROUGHT BACK TO POWER IN MARCH 1974 AND RE-ELECTED
IN OCTOBER OF THAT YEAR, THE LABOR GOVERNMENT HAS MORE
THAN TWO AND ONE-HALF YEARS TO RUN ON ITS TERM OF OF-
FICE. FEW OBSERVERS EXPECT IT TO FINISH THE FULL COURSE.
ITS THIN PARLIAMENTARY MAJORITY HAS BEEN WHITTLED AWAY

UNTIL ONLY A FEW SPLINTERS REMAIN.

3. BECAUSE HIS MAJORITY IN THE COMMONS IS NEARLY GONE, THE CURRENT PARLIAMENTARY YEAR WILL BE AS ROUGH AS THE LAST FOR THE PM. 1977 AT WESTMINSTER WILL BE DOMINATED BY TWO MAJOR CONSTITUTIONAL ISSUES: THE DEVOLUTION OF POWER TO SCOTLAND AND WALES AND DIRECT ELECTION OF BRITISH REPRESENTATIVES TO THE EUROPEAN PARLIAMENT. BOTH ARE HIGHLY CONTENTIOUS. BUT SINCE DIFFERENCES CUT SHARPLY AND EMOTIONALLY ACROSS PARTY LINES, NEITHER DEVOLUTION NOR DIRECT ELECTIONS IS LIKELY TO BRING THE LABOR GOVERNMENT DOWN. THEY WILL, HOWEVER, MAKE LIFE HELL FOR IT. ONCE THESE TWO ISSUES ARE SETTLED, CALLAGHAN WILL GO ON TRYING TO BEAT BACK THE OPPOSITION IN THE COMMONS, KEEP HIS OWN FRACTIOUS PARTY IN LINE, DREAM OF A LAND OF MILK AND HONEY BEYOND NORTH SEA OIL, AND PRAY FOR AN UPTURN IN THE ECONOMY. IF ALL THIS HAPPENS, HE WILL NO DOUBT CALL FOR A GENERAL ELECTION, PROBABLY IN 1978.

4. IN THE MEANTIME, THE ECONOMIC SITUATION HERE IS THE ALPHA AND THE OMEGA, FOR CABBIES AND FOR THE CABINET. THE CALLAGHAN GOVERNMENT MOVED TO MEET THE ECONOMIC CRISIS OF LAST FALL THROUGH CREDITS THROUGH THE IMF AND THE BANK FOR INTERNATIONAL SETTLEMENTS AS WELL AS DOMESTIC PUBLIC EXPENDITURE CUTS. THE CAUSES FOR THE OCTOBER-NOVEMBER CRISIS WERE MANY: HIGH INFLATION, A PRACTICALLY STAGNANT GNP, HEAVY GOVERNMENT EXPENDITURES, RECORD FISCAL DEFICITS, A POST-WAR RECORD LEVEL
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PAGE 03 LONDON 01243 01 OF 03 241554Z

OF UNEMPLOYMENT, SUBSTANTIAL BALANCE OF PAYMENTS DEFICITS AND A LARGE FOREIGN DEBT. LONGER RUN FACTORS HAVEN'T HELPED EITHER: A SOCIETY DIVIDED BY CLASS, CHRONIC LOW INVESTMENT, TRADITION-TIED MANAGEMENT, OVERMANNING AND LOW PRODUCTIVITY, AND THE UNSETTLING EFFECT OF CONTINUED DISAGREEMENT OVER THE PROPER MIX OF PRIVATE AND PUBLIC ENTERPRISE. ALL HAVE CONTRIBUTED TO BRING BRITAIN TO ITS CURRENT ECONOMIC PASS.

5. IN ATTEMPTING TO BUILD A BRIDGE ACROSS THIS SOCIAL AND ECONOMIC BOQ, THE LABOR GOVERNMENT'S STRATEGY HAS BEEN TO TRY TO RESTRAIN PAY INCREASES AND PRICE RISES IN ORDER TO BRING DOWN INFLATION, TO REDUCE GOVERNMENT AND CONSUMER EXPENDITURE, AND TO SHIFT RESOURCES INTO INDUSTRY IN ORDER TO DEVELOP A MORE COMPETITIVE INDUSTRIAL STRUCTURE AND STIMULATE EXPORT-LED GROWTH.

6. THAT STRATEGY IS SOUND. BUT TO UNDERSTAND IS NOT ALWAYS TO ACT. AND TO ACT IS NOT ALWAYS TO SUCCEED.

QUESTIONS NAG BRITAIN'S FRIENDS. CAN THIS GOVERNMENT
BURDENED BY ITS OWN IDEOLOGY-BOUND LEFT WING DO WHAT SO

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PAGE 01 LONDON 01243 02 OF 03 241557Z
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S E C R E T SECTION 02 OF 03 LONDON 01243

EXDIS

MANY OTHERS HAVE FAILED TO DO -- INSPIRE CONFIDENCE
AMONG THE PRODUCERS OF WEALTH AND CREATE THE INCENTIVES
NECESSARY TO REAL EXPANSION AND IMPROVEMENT IN THE IN-
DUSTRIAL SECTOR? CAN INFLATION BE FURTHER REDUCED?
CAN WAGE RESTRAINT BE MAINTAINED? NOBODY KNOWS. FEW
IN THE UK TODAY WOULD BET THEIR MORTGAGES THAT THIS
GOVERNMENT CAN COMPLETE THE JOB. MANY OTHERS SUSPECT
THE TORIES WOULD DO NO BETTER. AND EVEN IF CALLAGHAN
AND HIS COLLEAGUES DO BEGIN TO RESOLVE SUCCESSFULLY THESE
UNKNOWN, THE ROAD AHEAD FOR BRITAIN IN THE NEXT YEAR
OR TWO WILL STILL BE A WASHBOARD. UNEMPLOYMENT WILL
REMAIN HIGH. INFLATION WILL OUTSTRIP WAGE INCREASES
FOR A TIME. 1977 WILL SEE ANOTHER REDUCTION IN THE
REAL STANDARD OF LIVING OF THE BRITISH PEOPLE.

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PAGE 02 LONDON 01243 02 OF 03 241557Z

7. AS YOU CAN SEE, CALLAGHAN HAS ALL HE CAN HANDLE, AND MAYBE MORE. HE BECAME LEADER OF THE LABOR PARTY AND BRITAIN IN THE SPRING OF LAST YEAR AT 64, LATE IN LIFE AND UNEXPECTEDLY. HE HAD GIVEN UP HOPE OF EVER SUCCEEDING HAROLD WILSON. FEW OF CALLAGHAN'S PARLIAMENTARY COLLEAGUES, WHO ELECT THE LABOR PARTY LEADER, CONSIDERED HIM THE BEST MAN IN THE CABINET. HE WAS NEARLY EVERYONE'S SECOND CHOICE. IN THE EXHAUSTIVE LEADERSHIP BALLOTING PROCESS, THAT WAS GOOD ENOUGH TO GET HIM TO NO. 10. UNSURPRISINGLY, HE LIKES IT THERE.

8. CALLAGHAN IS A CONVINCED AND LONG-TIME ADVOCATE OF BRITAIN'S INTIMATE TIES WITH THE US. HIS ATTACHMENT IS BY NO MEANS BORN ONLY OF POLITICAL SELF-INTEREST. HE IS FOND OF SAYING THAT HE SINGS "AMERICA THE BEAUTIFUL" EACH MORNING UPON ARISING. HE EXPENDED PARTICULAR PERSONAL EFFORT TO CULTIVATE A WARM PERSONAL RELATIONSHIP WITH HENRY KISSINGER, AND WILL AIM TO ESTABLISH THE SAME SORT OF BOND WITH YOU, SECRETARY VANCE AND THE PRESIDENT.

9. AT THE MOMENT, THE MOOD OF THE PM AND OF MOST HMG LEADERS IS DISTINCTLY THAT OF MICAWBER: DOGGEDLY DETERMINED TO CARRY ON, UNCERTAIN WHERE THE NEXT BLOW MAY FALL, AND ETERNALLY HOPEFUL THAT IN TIME SOMETHING GOOD WILL TURN UP. THE GOVERNMENT IS SUPPORTED IN THAT HOPE, INDEED SUSTAINED IN OFFICE BY THE SOLID SUPPORT OF THE TRADE UNIONS. IN FACT, IN A RECENT POLL RESPONDENTS INDICATED THEY BELIEVED UNION TITAN JACK JONES TO BE A FAR MORE POWERFUL FIGURE THAN CALLAGHAN. UNDER JONES' LEADERSHIP, AND DESPITE CONSIDERABLE INFLATION, THE UNIONS HAVE FOR THE PAST TWO YEARS ACCEPTED VOLUNTARY RESTRAINT POLICIES. AS WE HAVE SUGGESTED, THIS WAGE RESTRAINT IS AN ABSOLUTE PREREQUISITE FOR ECONOMIC RECOVERY BUT INSUFFICIENT IN AND OF ITSELF. SAID SIMPLY,

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PAGE 03 LONDON 01243 02 OF 03 241557Z

NO LESS THAN A REVITALIZATION OF THE UK INDUSTRIAL SECTOR WILL BE REQUIRED TO PUT BRITAIN FIRMLY BACK ON ITS FEET. ENGLISH UNDERSTATEMENT WOULD SUGGEST THAT SUCH FUNDAMENTAL STEADINESS IS NOT AN IMMEDIATE PROSPECT HERE.

10. IN THE MONTHS AHEAD, THE SOCIAL STRAINS CAUSED BY

ECONOMIC HARDSHIPS COULD BE SEVERE. BUT IT IS A TRIBUTE TO THE STOICISM AND LEGENDARY PHLEGM OF THE BRITISH PEOPLE THAT DESPITE THE DOOMSDAY PREDICTIONS OF AMERICAN MEDIA, THIS PAST YEAR OF REDUCED LIVING STANDARDS AND THE PROSPECT OF TOUGH TIMES AHEAD HAVE BROUGHT NO INSTITUTIONAL INSTABILITY. HOWEVER, THE

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PAGE 01 LONDON 01243 03 OF 03 241558Z
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S E C R E T SECTION 03 OF 03 LONDON 01243

WIDESPREAD LOSS OF UK SELF-CONFIDENCE IS A CONSIDERABLE WORRY AND THE POLITICAL LEADERSHIP HAS NOT YET FOUND A WAY TO DO ITS PART IN OVERCOMING THIS NATIONAL MALAISE. BRITONS OF ALL CLASSES DEPRECATE THEIR OWN COUNTRY, ITS REDUCED ROLE IN THE WORLD, ITS PROSPECTS FOR ECONOMIC REVIVAL. GIVEN OUR RECENT HISTORY, AMERICANS WILL HAVE NO TROUBLE UNDERSTANDING THE CORROSIVE EFFECTS OF SUCH WIDESPREAD PSYCHOLOGICAL CONFUSION.

11. ANTHONY EDEN'S DEATH REMINDED GAIN HOW MUCH

THE UNITED KINGDOM'S ROLE HAS CHANGED SINCE SUEZ. IF
THE BRITISH PEOPLE ARE TO REGAIN A SENSE OF NATIONAL
PURPOSE, THE UK'S ECONOMIC DECLINE WILL HAVE TO BE
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PAGE 02 LONDON 01243 03 OF 03 241558Z

STAUNCHED AND REVERSED. CALLAGHAN STRONGLY BELIEVES
THE KEY TODAY TO THAT BRITISH RENAISSANCE IS DEPENDENT
ON EXPANSIONIST ECONOMIC POLICIES BY WASHINGTON, BONN
AND TOKYO AS WELL AS ON ACTIONS TAKEN IN THESE ISLANDS.
WHEN YOU MEET THE PRIME MINISTER, IT WILL BE THAT SINGLE
PREOCCUPATION MORE THAN THE IMMEDIATE DIPLOMATIC
PROBLEMS OF THE BRITISH EC PRESIDENCY, SOUTHERN AFRICA,
CYPRUS, OR THE MIDDLE EAST THAT WILL BE UPPERMOST IN HIS
MIND.

ARMSTRONG

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